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## Significant changes in the regulatory environment to affect the asset managers of foreign collective investment schemes

**The new regulations which will enter into force in 2013 will make it compulsory for asset managers of foreign collective investment schemes to obtain an authorization from FINMA - How to be prepared for these changes**

*In the wake of the financial crisis of 2008, the regulatory environment for asset managers of collective investment schemes has been subject to significant changes and become increasingly detailed.*

*In 2009, the European Union proceeded to the recast of its UCITS directive governing collective investments in transferable securities (the "UCITS IV Directive").*

*In November 2010, the European Parliament then adopted a directive on alternative investment fund managers (the "AIFM Directive") that is applicable to managers of alternative investment funds (private equity funds and hedge funds) as well as to managers of funds that are not regulated under the UCITS IV Directive. The AIFM Directive subjects these asset managers to a specific authorization and supervision regime and allows them to benefit from a passport to market alternative funds within the European Union.*

*According to the AIFM Directive which will enter into force in July 2013, the fund management of European alternative funds may be delegated to non-European asset managers (e.g. Swiss asset managers) only if these asset managers are subject to a supervision equivalent to the one foreseen by the AIFM Directive.*

*It is against this background that Switzerland has initiated the amendment of its Collective Investment Schemes Act ("CISA"). The draft amended statute (the "Draft Legislation") therefore provides, among other things, that all Swiss asset managers of collective investment schemes require an authorization from FINMA, irrespective of whether they manage Swiss or foreign funds.*

*As a result, there is a certain urgency for Swiss asset managers of European alternative investment funds to take the necessary measures to ensure that they meet the legal requirements allowing them to pursue their activity, as they will only be authorized to continue offering these services if they have obtained FINMA's approval by July 2013.*

*Moreover, all the Swiss asset managers of foreign collective investment schemes (not only European alternative investment funds) must prepare for the planned entry into force of the amended CISA at the beginning of 2013.*

## Amendment of the CISA in a nutshell

On 2 March 2012, the Federal Council published its proposal regarding the partial amendments of the CISA. The amended text has not yet been finalized, as it may soon be modified in the course of the debates that will take place in the Swiss Parliament.

According to the Federal Council, the Draft Legislation aims at filling the existing gaps in the area of investors' protection and to maintain Switzerland's competitiveness in the field of the management of collective investment schemes. The Draft Legislation adapts the existing Swiss legislation to the international requirements with respect to the management, safekeeping and distribution of collective investment funds.

### **1. Authorization for Swiss asset managers of foreign funds**

With regard to the management, the Draft Legislation subjects not only the asset managers of Swiss funds to an authorization requirement, as required by the CISA currently in force, but also the asset managers of foreign funds. Certain small structures will however benefit from some exceptions.

It is important to note that the obligation (and right) to obtain an authorization only applies to the asset managers of collective investment schemes. Mere investment advisors are not subject to this obligation. The delimitation between these two types of activities is however not always clear, and it must therefore be determined, based on the circumstances of each individual case, whether the manager makes the investment decisions in an independent manner and executes these decisions for the account of his clients.

Furthermore, the Draft Legislation provides for a tightening of the requirements applicable to authorized entities so as to adapt the CISA to international standards. In particular, it introduces stricter provisions regarding capital adequacy, responsibility in case of delegation and the management of conflicts of interest.

### **2. Tightening of custodians' obligations**

With respect to the requirements regarding the safekeeping, the Draft Legislation provides that the custodian may not delegate the safekeeping of the collective funds to a third party that is not subject to supervision in Switzerland or abroad. The investor must furthermore be informed of the risks related to this delegation. Additionally, the custodian will in the future be responsible for losses caused by a third party to which it has delegated the execution of its tasks, unless it proves that it has applied all the care required under the circumstances in selecting, instructing and supervising the third party.

### **3. New definition of qualified investors as well as new particularly strict requirements with respect to distribution**

According to the Draft Legislation, a foreign collective investment scheme may only be distributed in or from Switzerland, to qualified investors or to non-qualified investors, if it has beforehand appointed a Swiss representative, whose duty is notably to verify regularly whether the collective investment scheme is subject to a regulation equivalent to the CISA. Additionally, the distribution of the foreign collective investment scheme

will only be permitted if FINMA has concluded a cooperation agreement with the foreign supervision authorities concerned by the distribution. These two requirements risk to considerably restrict the number of products distributed in Switzerland.

Furthermore, the definition of qualified investors has been modified. High-net-worth individuals (who own financial assets of at least CHF 2 million) will no longer automatically be considered as qualified investors; they will in particular need to possess technical competences in financial matters.

Also, clients having appointed a bank or an independent asset manager with the management of their assets will no longer be considered as qualified investors. The Draft Legislation however provides that the acquisition of units in collective investment schemes in the context of a discretionary asset management mandate shall not be considered as a distribution subject to the CISA.

The consequences of the modifications intended by the Draft Legislation could therefore be significant for the activity of certain financial intermediaries - particularly those who provide investment advices - who will therefore need to closely examine whether they require a distribution authorization and determine the impact on their activity of the new definition of qualified investors.

## Application for a FINMA-authorization for asset managers of foreign collective investment schemes

Despite the still uncertain outcome of the amendment of the CISA, FINMA decided to anticipate the significant regulatory changes pending in Switzerland and abroad as well as the number of applications for authorization that will be filed in view of these modifications.

In its Communications 34, 35 and 36, FINMA in particular addresses companies which must obtain an authorization in Switzerland as asset managers of foreign collective investment schemes due to the regulatory changes taking place abroad, in particular following the adoption of the AIFM Directive.

The entry into force of the AIFM Directive in July 2013 will result in the asset management of European alternative funds only being able to be delegated to Swiss asset managers that are subject to a supervision equivalent to the one stipulated in said Directive.

FINMA has therefore drawn the attention of the concerned companies to the fact that they will need to decide without delay whether they intend to file an application for authorization based on the law currently in force or whether they prefer to await the on-going amendment of the CISA, in which case they may not receive the authorization within the required time frame.

In order to facilitate the authorization procedure, FINMA specified its expectations in connection with the content and form of the relevant application in its Communications 34, 35 and 36.

### 1. Deadlines

According to FINMA's indications, applicants wishing to have a realistic chance of obtaining an authorization within the deadline **should file their application prior to 30 June 2012**. Consequently, asset managers who choose to pursue their activity as asset managers of European alternative investment funds cannot await the entry into force of the new CISA, but must already obtain an authorization based on the law currently in force.

It should be noted here that the statistics published by FINMA demonstrate that the processing of an application takes an average of 249 days.

## **2. Authorization requirements**

On several occasions, FINMA has pointed out that asset managers must fulfill all the authorization requirements already upon filing their application. Therefore, FINMA will only proceed to a material review of an application if the concerned asset manager can, at any rate prima facie, demonstrate that all the basic requirements as well as the financial, personal and organizational conditions are fulfilled and that it has filed all required documentation in this respect.

### **2.1. Basic requirements**

The asset manager must have its registered office in Switzerland.

Furthermore, although an asset manager could exercise its activity as an individual under the current CISA, in practice, the asset manager must be organized in the form of a company limited by shares, a partnership limited by shares, a limited liability company, or a general or limited partnership (the most commonly used legal form however being the company limited by shares).

The asset manager furthermore needs to demonstrate that it manages at least one collective investment scheme.

Finally, the asset manager must establish, on the one hand, that the relevant foreign law requires it to be subject to a governmental supervision and, on the other hand, that the collective investment scheme that it manages is subject to a supervision equivalent to the one in Switzerland.

In this respect, although FINMA states that the supervision of funds approved under the UCITS IV Directive shall be considered as comparable to the supervision in Switzerland, it does not provide any further clarification as to these requirements. It is therefore up to the asset managers to demonstrate that these two conditions are met in their case.

### **2.2. Financial requirements**

The asset manager must present certain financial guarantees. Hence, it must dispose of a minimum paid-up capital of CHF 200'000. Furthermore, equity capital corresponding to a minimum of a quarter of the fixed costs of the last accounting period must be available.

### **2.3. Personal requirements**

The authorized entity must have qualified personnel with the necessary competences in its area of activity. Additionally, the persons responsible for the management and business operations must guarantee proper management, have a good reputation and possess the requisite professional qualifications. FINMA will therefore carefully examine the applications with respect to the members of the board of directors and of the management, the persons responsible for a service/department, the RISK MANAGER and the COMPLIANCE OFFICER.

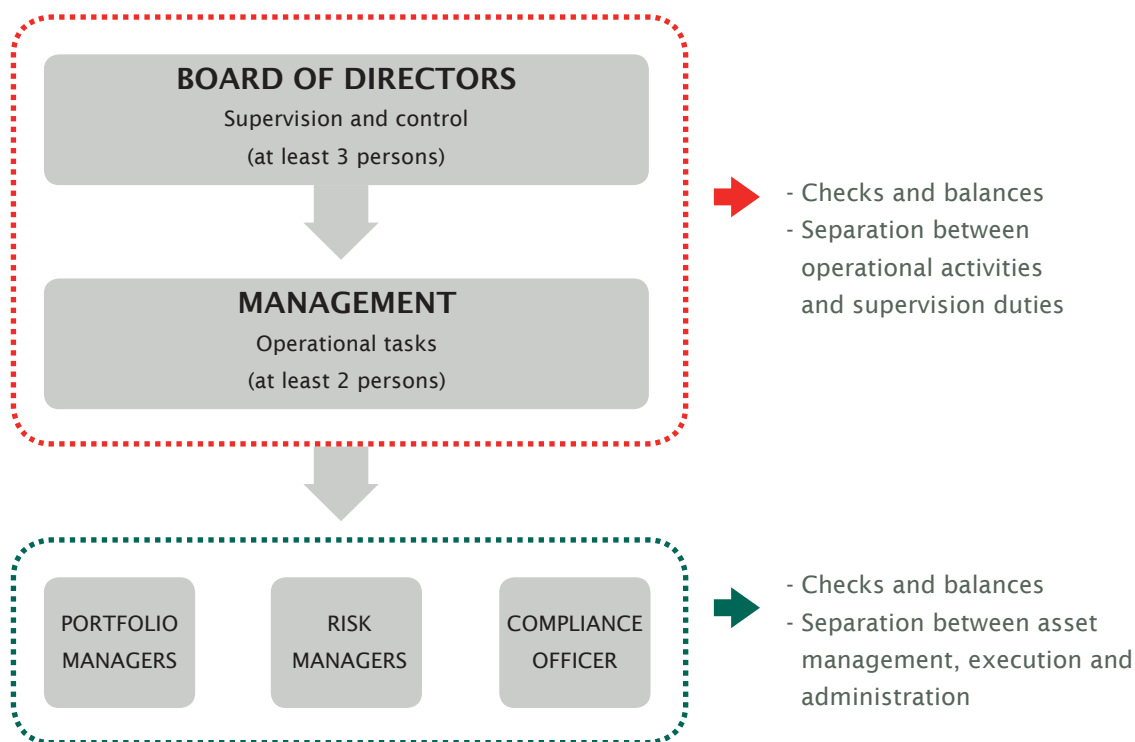
### **2.4. Organisational requirements**

In practice, these requirements often constitute the main hurdle, as the CISA provides for a relatively burdensome and strict organization.

Indeed, the CISA requests a separation between the company management on the one side and the tasks of the upper management, supervision and control on the other side.

Consequently, in order to meet these conditions, an asset manager of collective investment schemes must present the following minimal organization:

- **BOARD OF DIRECTORS:** acts as upper management of the company and consists of at least three members, the majority of which do not carry out any operational tasks.
- **MANAGEMENT:** deals with the current business of the company according to the instructions of the board of directors and consists of at least two persons. The members of the management must be domiciled at a place allowing them to actually handle the business operations, i.e. nearby the actual seat of the company.
- **RISK MANAGER:** this function must be independent from the functions regarding the investment decisions. The risk manager must be experienced and possess particular professional qualifications.
- **COMPLIANCE OFFICER:** this function requires experience, professional competences adapted to the business and a large degree of independence.
- **PORTFOLIO MANAGERS:** must also be qualified since the financial products currently available on the market are often quite complex.



Translated slide from FINMA informational session of 26 March 2012

Source: <http://www.finma.ch/d/beaufsichtigte/Documents/pt-informationsveranstaltung-vv-kka-d.pdf>

The law requires that the company's overall organization be described in detail by the authorized entity and that the principle of prohibition of a plurality of functions be set out in the company's organisational rules.

## Conclusions

Asset managers of foreign collective investment schemes that do not currently hold a FINMA-authorization would therefore be well advised to rapidly obtain one, as this is a requirement for them in order to continue carrying out their activities.

The concerned asset managers will first have to ensure that they fulfill the authorization requirements and that the collective investment schemes that they intend to manage comply with the applicable laws.

The application for authorization involves substantial preparations and the processing of the files by FINMA may take more than eight months. Asset managers are therefore advised to launch the procedure as soon as possible.

## Contacts

The content of this newsletter is for information purposes only and does not constitute a legal advice or opinion. Should you require specific advice in this matter, please get in touch with your usual contact at ALTENBURGER or with one of the below authors of this newsletter:

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